PAKISTAN

TRADE SUMMARY

In 2000, the U.S. trade deficit with Pakistan was $1.7 billion, an increase in the deficit of $391 million from the previous year. U.S. exports to Pakistan were $462 million in 2000, an increase of $36 million (8.43 percent) from 1999. Pakistan was the United States' 65th largest export market in 2000. U.S. imports from Pakistan totaled $2.16 billion in 2000, an increase of $427 million (25 percent) from the level of imports in 1999.

The stock of U.S. foreign direct investment in Pakistan in 1999 was $488 million, a decrease of 3.3 percent from 1998.

OVERVIEW

During 2000, Pakistan's economy showed some signs of improvement and stability with a modest growth rate of 4.8 percent, an increase from last year's growth rate of 3.2 percent. This modest recovery was supported by a strong performance in agriculture and a slight pick up in the services sector, while the large scale manufacturing sector continued in recession, registering a growth rate of only 0.04 percent. A combination of domestic and external shocks kept the economy under stress; these shocks included the takeover by the military government, delays in negotiating a new program with the IMF and a rise in world oil prices. A slowdown in the informal economy and cuts in productive public spending over the last few years have reduced opportunities for economic expansion and employment generation. The military government's economic agenda, which is based on accountability, improved governance and broadening of the tax base created major structural shifts in the economy resulting in substantial short-term transitional costs. These structural measures may, however, lay the foundations for sustainable growth in the future. An area of concern is the 1999 Pakistan Supreme Court ruling ordering the government to implement an interest-free economy by June 30, 2001. The government has created several commissions to develop the ways and means to carry out this decision.

The military government has made economic revival a main priority. Its stated goals are restoring investor confidence through stability and consistency in economic policies, increasing domestic savings, reforming the tax system, privatizing and reforming state enterprises, boosting agriculture and reviving industry to promote exports and information technology and reducing imports, especially through increased agricultural production of wheat and edible oils. The government targeted the oil and gas sector for further development and increased foreign investment, planning to offer liberal incentives for exploration and to privatize several major government entities in this sector. The new government is also attempting to address widespread corruption throughout the economy. Over the last year progress has been made with regard to preparation of the reforms, but their success depends on the government's ability to implement them. To date, this government has been able to make significant progress in tax documentation through an extensive business and residential tax survey; it has not, however, been able to use the information collected to generate significant increases in revenue.

Pakistan faces a critical balance of payments situation with net foreign exchange reserves of just $1.4 billion, including $400 million in foreign exchange accounts, as of December 20, 2000. The Government of Pakistan has recently concluded a Stand By Arrangement (SBA) with the IMF, paving the way for further rescheduling of Pakistan's external debt with official and commercial creditors in early 2001. This rescheduling is necessary to avoid defaulting on over $3.0 billion in loan payments due in 2001. This agreement has also resulted in new lending from other IFIs.

IMPORT POLICIES

The Pakistani Government had committed itself to further liberalize its trade regime in

compliance with the IMF/World Bank Policy framework paper of December 1998. Consistent with this commitment, on March 31, 1999, the maximum import tariff was reduced from 45 percent to 35 percent. The tariff for consumer goods was reduced to 35 percent, for intermediate goods reduced from 35 percent to 25 percent, for chemicals and components reduced from 25 percent to 15 percent, and for basic raw materials reduced from 15 percent to 10 percent. In addition, customs duties on agricultural machinery were reduced to 10 percent in May 1999. The government has also committed to reduce further the maximum import tariff to 30 from 35 percent by June 2001. The government has done away with most of its quantitative restrictions on imports. Commercial banks imposed cash margin requirements on imports for a temporary period to stop a free fall of rupee after the government decided to float the exchange rate on July 20, 2000; these recent cash margin requirements have now been withdrawn. In November 2000, following a delay of several years, Pakistan reached an agreement with the WTO Balance of Payments Committee to phase out quantitative restrictions on imports of textiles. Pakistan's Trade Policy 2000, however, bans imports of 44 items mostly on religious, environmental, security and health grounds. The banned items, on the so-called "Negative List, " also include some textile products such as woven cotton fabrics, woven synthetic fabrics, bed linens, curtains, certain knitted fabrics and apparel items, tents, carpets and textile floor coverings. Many items on the Negative List happen to be key Pakistani export products.

Pakistan continued certain detrimental import restrictions, mostly questionable fees and preferential tariff rates. Pharmaceutical-related raw materials and soda ash continue to suffer from these barriers. The U.S soda ash industry estimated losses in potential exports at $25 - $50 million annually. U.S. industries have expressed particular concern with the Government of Pakistan's discriminatory application of the internal sales tax between imported pharmaceutical raw materials (taxed at 15 percent) and the same domestically produced raw materials (exempt from taxation). Moreover, industry believes that Pakistan's imposition of price controls on pharmaceutical end products further impedes U.S. pharmaceutical manufacturers from maintaining profitability. Industry has estimated that removal of these barriers would result in increased sales of U.S. pharmaceutical companies' products of $50-100 million.

The Pakistani tariff regime is generally characterized by complexity, broad bureaucratic discretionary powers, and very limited transparency. Administrative decisions frequently grant exemptions and concessions from general rules under Special Regulatory Orders

(SRO) that amount to temporary duty suspension decrees. As a result, different rates are applied to the same product and average applied rates are sometimes lower than statutory duties. The IFI reform programs address these problems. Simplifying the tariff regime will benefit U.S. exporters. The new government has also spoken out generally against the prior government's abuse of the SRO authority. Other U.S. exports that continue to face market access restrictions include instant print film and instant print cameras. In addition to the range of border and internal market restrictive barriers in Pakistan on the industry's products, U.S. film and entertainment industry representatives have estimated an annual loss of approximately $1 million due to the entertainment taxes.

CUSTOMS BARRIERS

The government canceled its controversial pre-shipment inspection valuation system in March 1997. In January 2000, the government began implementing a transactional valuation system where 99 percent of import valuation is based on invoices pursuant to the WTO's Customs Valuation Agreement. The government, however, faces problems in implementing this system due to inadequate infrastructure. Investors and importers complain that the government incentives advertised at the policy level are not actually granted by customs officials at the time of import. In January 2001, Pakistan announced a drastic fall in customs-generated revenues due to problems stemming from the implementation of the Customs Valuation Agreement, and requested a waiver from the WTO to restore minimum value prices for certain imports. Many of those products identified for minimum value treatment are key Pakistani export products, including textiles.

STANDARDS, TESTING, LABELING AND

CERTIFICATION

Pakistan's barriers to trade often are expressed as extra fees. Less frequently, usually in the context of protecting some domestically manufactured product, the U.S. exporter will

encounter difficulty with "Quality" standards. Testing facilities for agricultural goods are inadequate, and standards are inconsistently applied, resulting in occasional discrimination against U.S. farm products.

GOVERNMENT PROCUREMENT

Pakistan is not a member of the WTO Agreement on Government Procurement. The Pakistani Government, along with its numerous state-run corporations, is Pakistan's largest importer. Work performed for government agencies, including purchase of imported equipment and services, often is awarded through tenders that are publicly announced or issued to registered suppliers. The government nominally subscribes to principles of international competitive bidding, but political influence on procurement decisions is common, and these decisions are not always made on the basis of price and technical quality alone. Charges of official corruption and long delays in bureaucratic decision-making have been common in the past. The sanctity of contracts has also been an issue for some companies dealing with the past government although the recent resolution of a contract dispute with a major private power company (Hubco) sends a positive signal to potential investors in Pakistan. The new military government has placed a high priority on good governance and rooting out corruption, and has established an office for procurement reform in an attempt to introduce and enforce better procurement practices in Pakistan. Industry estimates that if these barriers were eliminated, U.S. exports would increase by $10-25 million.

EXPORT SUBSIDIES

Pakistan actively promotes the export of Pakistani goods with measures such as

government financing and tariff concessions on imported inputs, and income and sales tax concessions. Pakistan has established export processing zones with benefits including tax holidays, exemption of imports from taxes and duties, and exemption from labor laws and various other regulatory regimes. Incentives for exports, including export financing, appear to be available to both foreign and domestic investors.

In 2000, the Pakistani Government did not provide any export subsidies for any of its major agricultural products of cotton, wheat and rice. The government did provide a freight subsidy for exports of potatoes, onions and citrus fruits. (The freight subsidy for citrus fruits was country specific and was meant only for Bangladesh.)

INTELLECTUAL PROPERTY RIGHTS PROTECTION

The laws in Pakistan generally provide for protection of intellectual property rights.

Pakistan is a member of the World Trade Organization and has enacted four major new laws relating to patents, copyrights, industrial designs and layout designs for integrated circuits during 2000 in an attempt to bring these areas into compliance with the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). New laws on trademarks and plant breeders' rights are drafted and awaiting approval. Pakistan is a party to the Berne Convention for the Protection of Literary and Artistic Works, the Universal Copyright Convention, and is a member of the World Intellectual Property Organization. However, it is not a party to the Paris Convention for the Protection of Industrial Property.

Pakistan has been on the "Special 301" Watch List since 1989 due to widespread piracy, especially of copyrighted materials, and failure to implement its patent mailbox obligations under the TRIPS Agreement. Senior government officials are aware of the negative impact of intellectual property rights violations on Pakistan's investment climate. The government realizes the need to provide better protection for intellectual property rights in Pakistan, due to Pakistan's desire to grow and protect its nascent information technology industry and has improved and enacted laws relating to copyrights, patents, industrial designs and layout designs for integrated circuits. The new copyright law, for example, considerably increase fines for copyright infringement and also provides for imprisonment as a penalty.

Patents

Pakistan has recently enacted a new patent law that protects both process patents and product patents in accordance with its WTO obligations. In addition, under this law both the patent-owner and licensees can file a suit against an infringer. However, backlogged cases in the courts could result in delays in issuing injunction orders against the infringer. U.S. industry reports that piracy continues to inflict losses on the research-based pharmaceutical industry at an estimated cost of $15-20 million per year.

Trademarks

There have been occasional instances of trademark infringement, involving a range of products such as toys, playing cards, and industrial machinery. In August 1994, the Pakistani Government issued new drug labeling rules requiring the generic names of substances to be printed with at least equal prominence as that of the brand name. This rule serves to dilute in the minds of consumers existing differences in quality and safety, and incorrectly implies total interchangeability and equality among different products. Industry has expressed concern about Pakistan's drug labeling rules, noting that these laws appear to place Pakistan in violation of the WTO TRIPS rules protecting trademarks. A new trademark law to bring Pakistan in compliance with TRIPS has been drafted but awaits final approval. U.S. industry estimates a loss of $5-10 million in U.S. exports for patent and trademark violations.

Copyrights

Violations of intellectual property rights in Pakistan are most common in the area of copyrights, where the piracy levels are exceptionally high. The market for imported computer software has remained nearly 95-percent pirated until recently (multinational firms and other international agencies are the only users of genuine software), while U.S. industry has estimated that the piracy rate for videos has declined to around 80 percent. The most troubling development is the growth of optical media piracy. Industry estimates a 90-percent piracy rate for optical discs, stemming from the rapid growth of illegal production plants. Industry estimates that as many as seven optical media plants have opened in Pakistan since 1999, with a production capacity of 100 million units. Illegal CDs from these plants have inundated the local market and have been found for sale in the Middle East and south Asia.

The government has recognized the need for better protection of software in order to establish a Pakistani information technology industry, promote industry standards, and encourage electronic commerce. The new amended copyright law bans the import and export of infringing copies. The law also provides for punishment of infringers with an imprisonment, which may extend to three years, and a fine of up to 100,000 rupees ($1,695).

Despite moderate improvements to law enforcement efforts, U.S. industry continues to express concern over the high rate of video piracy in the form of back-to-back copying of videos in video outlets. Furthermore, the entertainment industry reports that motion picture infringement cases move slowly through the court system due to case backlog. Piracy of copyrighted textile designs and reprint piracy of books (especially computer books, business titles, and medical texts) continue to be significant problems. The new copyright law may not address sufficiently protections for literary works. It is too soon to assess the government's implementation of the new copyright law, and whether higher penalties for copyright infringement will act as a deterrent to piracy.

Despite improvements in enforcement, the courts have been lax regarding successful

prosecution of copyright infringement. In the area of copyright infringement alone, in Pakistan, the International Intellectual Property Alliance estimates that piracy of films, sound recordings, computer programs, and books resulted in trade losses of $136.9 million in 2000, slightly more than double the total losses for 1999.

SERVICES BARRIERS

In 2000, the Government of Pakistan extended an investment liberalization policy started in 1997 by reducing areas of bureaucratic discretion and offering more tax and other incentives in the infrastructure, services and the agriculture sectors. The recently modified investment policy, for example, places tourism, housing and construction in the category of "priority industries," meaning that they pay only a 10 percent-custom duty (as compared to the maximum tariff rate of 35 percent) on imported plant, machinery and equipment, and receive significant first-year tax relief for the cost of machinery. In addition, there is no minimum amount of equity investment, and investors in these sectors may hold 100-percent foreign equity. The policy also allows services and other non-manufacturing sectors (including international food franchises) to remit technical fees and royalties, although there are several conditions. In the agriculture and infrastructure sectors, the recent changes increased fiscal relief in the first year allowance from 50 percent to 75 percent of the machinery cost. The policy now also provides for a comprehensive list of value-added industries, which are entitled to the highest level of incentives. These include no duty on imported plant, machinery or equipment and a first year fiscal allowance of 90 percent of the cost of machinery.

The modified policy now allows investors to invest in any activity falling under the services sector. In general, investment in services is permitted under the modified policy where the amount of foreign equity investment is at least $300,000. Foreign investors are allowed to hold up to 100-percent equity at the outset subject to the condition that repatriation of profits will be restricted to a maximum of 60 percent of total equity or profits. The policy also requires that 40 percent of equity be held by Pakistani investors within five years of the initial investment. Foreign investments not meeting these requirements are still permitted, but are not guaranteed, repatriation of profits.

Information technology services, including software development , however, have been defined as an "industry" by the investment policy, which means that foreign investors are allowed participation on the basis of 100 percent foreign equity, and are neither subject to a minimum investment requirement nor are required to have 40 percent Pakistani equity within five years.

There is a specific list of deregulated telecommunications services, including electronic information services, card-pay telephone services, paging services and voice mail services. The investment policy permits 100-percent foreign equity on a repatriable

basis as long as foreign equity investment is at least $300,000. Basic telephony remains the monopoly of the majority state-owned Pakistan Telecommunications Corporation until 2005, but competition among service providers is now allowed in cellular telephony. In WTO negotiations on basic telecommunications, Pakistan made commitments on basic telecommunications services, with a phase-in on some obligations. For example, Pakistan has agreed to provide cross-border market access for voice services as of January 1, 2005, and will allow the cross-border provision of packet-switched data and Internet services on competitive networks by 2004. As part of the agreement, Pakistan also adopted certain pro-competitive regulatory principles.

Pakistan improved its financial services commitments in the WTO financial service

agreement in December 1997. These commitments promise some liberalization by

granting the right of establishment for banks, as well as grandfathering acquired rights of foreign banks and foreign securities firms. Foreign banks generally have been restricted to 25 branches, and are subject to ceilings on lending to state-owned corporations. Although these ceilings (called "public sector ceilings ") also apply to local banks, they are decided by the State Bank of Pakistan and are discretionary in nature and, thus, could be discriminatory. Foreign brokers may join one of the country's three stock exchanges only as part of a joint venture with a Pakistani firm.

The few foreign insurance companies operating in Pakistan have faced various tax problems, long delays in remitting profits, and problems associated with operating within the insurance cartel. The new government has opened the insurance market as one of its reforms of the financial sector. Foreign investors are allowed to hold 51 percent shares of companies operating in the life and general insurance sectors. They, however, are required to bring in the minimum amount of $2.0 million in foreign exchange and raise an equal amount in equity in the local market. There are no restrictions on the repatriation of profits but the capital investment made in these sectors cannot be repatriated. The GOP also issued a new insurance law in 2000 that strengthens the insurance market by raising financial requirements and offers better protection to policy holders.

Service barriers in the form of admission price controls set by provincial governments remain a matter of concern for U.S. film and entertainment industries. Admission price

controls coupled with high entertainment taxes have made it very difficult for theaters to be profitable; theater owners lack the authority to set admission prices according to market conditions. U.S. industry sources report provincial governments made no attempts to alleviate these controls in 1999-2000.

If all service barriers were eliminated, U.S. industry representatives estimate an increase in U.S. exports of $25-100 million.

Legal Services

A person can provide legal consultancy services on foreign and international law without being licensed to practice law in Pakistan. Unless they are licensed in Pakistan, however, foreign lawyers may not appear in court or otherwise formally plead cases, even if they work with local lawyers. Foreign lawyers can form law firms in Pakistan as long as there is 40 percent Pakistani equity within five years of initial investment.

INVESTMENT BARRIERS

As mentioned above, the new investment policy of November 1997 promised liberalization of the climate for foreign direct investment. Foreign investors are allowed to invest in the manufacturing and industrial sector on the basis of 100-percent foreign equity without government permission. (Several sectors, such as explosives, radioactive substances or alcohol manufacturing, are exempt for security or religious reasons.) The investment policy promises full repatriation of capital, capital gains, dividends, and profits with the approval of the State Bank of Pakistan; no restrictions on transfer of technology; expropriations only upon adequate compensation; and no changes in benefits and incentives to the disadvantage of investors.

Investors often face unstable policy conditions, however, particularly on large infrastructure projects. For example, the previous government's consistent harassment of, and refusal to recognize its contractual commitments to Independent Power Producers severely damaged Pakistan's attractiveness to foreign investors. The current government, however, has recently resolved all outstanding issues with the Independent Power Producers, which may improve the climate for investment. In the past, changes in governments have led to significant alterations in the conditions and assumptions under which an investment agreement had been signed or was being pursued.

Trade-Related Investment Measures

In 1995, Pakistan notified measures inconsistent with its obligations under the WTO Agreement on Trade-Related Investment Measures (TRIMS). These measures are local content requirements in the automobile, electronics, electrical products, and engineering industries under Pakistan's "deletion program." The program is ostensibly not compulsory, but at least one telecommunications equipment producer has

reported that telecommunications licensees must adhere to the import-deletion program. Investors who "voluntarily" undertake to increase the local content of their output enjoy lower tariffs on imported inputs but are subject to fines for non-compliance with an agreed-upon import deletion schedule. In the auto sector, U.S. industry reports that the Pakistani Government expects new motor vehicle assembly plants to achieve a local content level of at least 40 percent within five years of starting production. U.S. industry reports further that a 40-percent local content level is a firm requirement seven years after starting production of motor vehicles in Pakistan. Proper notification allowed developing-country WTO members to maintain such measures for a five-year transition period, ending January 1, 2000. In December 1999, Pakistan submitted a request to the

WTO for a lengthy, seven-year extension to its transition period. The United States is working with other WTO members to effect a case-by-case review of all such TRIMS extension requests, with an effort to ensure that the individual needs of those countries that have made requests can be addressed. This process does not limit a Member's rights under the WTO agreement.

OTHER BARRIERS

Lack of transparency is a recurrent and substantial problem in many areas, including

government procurement and customs valuation. Two Pakistani Federal Government bodies take an interest in this problem, in addition to various government departments that might investigate allegations of corruption under their purview. The new military government has targeted corruption as one of its highest priorities, creating a National Accountability Bureau (NAB) and promulgating a strict accountability ordinance aimed at rooting out corruption committed by prior government officials and politicians, tax evaders and fraudulent loan defaulters. A number of prominent persons have been arrested, with more arrests promised in the future. This accountability campaign

has not been able to restore funds on a significant scale, however. There has been a decrease in corruption at the top level, although there have been no big infrastructure projects under the new government to test its resolve. Lower-level corruption remains endemic.